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REPORT OF THE EXTERNAL AUDITOR, FINANCIAL PERFORMANCE REPORT AND PROGRAMME PERFORMANCE REPORT FOR THE BIENNIUM 1994-1995

Comments of the Director-General on the report of the External Auditor

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Introduction

1. The present document provides the comments of the Director-General on the report of the External Auditor covering the period 1994-1995 (IDB.16/2 - PBC.12/2). As in the past, many comments of management made on the draft audit report are reflected in the final report. However, the Director-General feels it necessary to make additional comments so that Member States are presented with a balanced view on the audit findings. The Director-General, in presenting his views, would like to express his appreciation of the observations and recommendations made by the External Auditor and the constructive manner in which the audit was carried out.

I. GENERAL COMMENTS

2. The Director-General welcomes the more analytical and informative style of the report, which provides a new insight into the operations of the Organization. The report also provides a more balanced perspective: while pointing out areas that need improvement, it also refers to limitations imposed by forces beyond the control of the Director-General and the Secretariat.

II. SPECIFIC COMMENTS

3. As recognized by the External Auditor, the Secretariat presented the financial statements in a new format under the revised accounting standards, following the recommendation of the Consultative Committee on Administrative Questions (CCAQ), Financial and Budgetary Questions (FB). The Secretariat took the initiative to present relevant information in a new, condensed form to enhance transparency and accountability to Member States.

Summary of findings and conclusions (paras. 9-41)*

4. The Director-General notes that the summary does not contain the clarifications made or actions taken by the Secretariat on the reported findings. Secretariat comments, clarifications and actions already taken are contained only in the main body of the report. In order to provide Member States with a balanced overview the Director-General suggests that the External Auditor, in future reports, reflect the views of the Secretariat in the summary of findings and conclusions as well as in the main body.

Budgetary, accounting and financial reporting procedures

Regular budget assessed contributions income (paras. 9, 42-46)

5. The Director-General fully concurs with the comments of the External Auditor on the arrears of assessed contributions. With a view to expediting timely payment of assessed contributions, the Secretariat has proposed certain remedial measures to the open-ended discussion group of representatives from Member States to study applicable measures to expedite the timely payment of assessed contributions (IDB.15/Dec.4). The Director-General clearly wishes the Member States to demonstrate their support for the Organization by meeting their financial obligations in full and on time.

Regular budget implementation (paras. 10, 47-51)

6. Delayed payment, or non-payment, of assessed contributions forced the Director-General to take a number of measures to reduce expenditure, mainly in administrative and support functions. This has led to an extraordinarily high balance of appropriations at the level of 10.1 per cent at the end of 1995.

Regular budget overexpenditures (paras. 11, 52-55)

7. The Secretariat acknowledges that the amount of $68,851 was transferred as a result of savings largely from one major object of expenditure (supplies and materials) to another (contractual services) and that this was not submitted to the policy-making organs for their approval as required by financial regulation 4.3(b), owing to an oversight. The Secretariat exercises the utmost vigilance in this area and considers the oversight as exceptional.

Regular budget unliquidated obligations (paras. 12, 56-60)

8. The Secretariat agrees with the comments of the External Auditor. The requirement to confirm in writing the validity of obligations at year end is now included in the amendment to the administrative instruction which designates certifying officers. For future year-end reviews of regular budget unliquidated obligations, appropriate follow-up will be carried out with individual certifying officers.

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* Paragraph numbers refer to paragraphs in the report of the External Auditor (IDB.16/2-PBC.12/2).

Accounting and reporting procedures: Commitments approved for future fiscal periods
(paras. 13, 61-66)

9. The Secretariat accepted the recommendation of the External Auditor and has amended financial rules 104.3 and 109.6(b) to bring the legislative provision into line with actual procedures. The Secretariat also welcomes the initiative of the External Auditor to have the definition of, and accounting practices for, commitments discussed at the next meeting of the Panel of External Auditors.

Liquidity position (paras. 14-15, 70-77)

10. The Secretariat wishes to point out that, by applying contributions received by the Working Capital Fund from the United States of America against unpaid assessed contributions of the same contributor, the Fund has effectively been reduced from $9 million to $6.75 million. Ninety per cent ($5.9 million) of the reduced Fund was used as an advance to the General Fund as at 30 June 1996.

Cash flow statement (paras. 16-18, 78-80)

11. The Director-General is pleased to note the positive remarks of the External Auditor on the new presentation of the cash flow statement, which follows the revised accounting standards as approved by the CCAQ (FB) and endorsed by the Administrative Committee on Co-ordination (ACC).

Bank reconciliation (paras. 19, 81-83)

12. The Director-General appreciates the positive remarks of the External Auditor on bank reconciliation as at 31 December 1995.

Voucher and cheque register
(paras. 20, 84-86)

13. While the Secretariat appreciates the advice of the External Auditor regarding the introduction of an electronic data processing (EDP)-supported control of the cheque and voucher register, computerization projects have to be carefully assessed, prioritized and controlled within the available resources and the Organization's information technology strategy, as recommended by the External Auditor in paragraph 159. Management Information Service (MIS), together with the Information Technology Management Committee (ITMC), are formulating a comprehensive information technology strategy, as part of which the priority of implementing an electronically controlled cheque register will be considered.

Cash management

Liquidity planning (paras. 21, 87-91)

14. The Secretariat agrees with the External Auditor that good reporting procedure is a prerequisite for optimizing liquidity planning. To implement the recommendation of the External Auditor made in October 1995, Treasury has been granted access to the requisition stage of the electronic procurement system since November 1995. As the information in that system is not yet complete, it is of partial use in liquidity planning. Full implementation of the procurement system should result in an improvement in liquidity planning.

15. As indicated in the Secretariat's comment to the recommendation of the External Auditor on information technology (chap. VII, paras. 154-158), the requisition stage of the procurement system is being fine-tuned, and training for the substantive divisions started in August 1996. The system will be expanded on a test basis to cover purchase requisitions for technical cooperation and Headquarters procurement. During the testing period, further fine-tuning will be made based on user feedback. After full implementation, expected in the second quarter of 1997, enhanced liquidity planning would be possible.

Investments and interest earnings (paras. 22, 92-103)

16. After having carefully considered the recommendation of the External Auditor in paragraphs 97-98 that the Secretariat should make investments in United States dollars rather than Austrian schillings, the Secretariat reached the conclusion that the difference in the yield between United States dollars and Austrian schilling investments does not warrant the risk of judgemental errors that could result when arranging fixed forward (FX) deals in exchanging currencies. As Member States are assessed in both United States dollars and Austrian schillings, the Organization cannot afford to incur losses linked to the fluctuation in exchange rates, and this risk, in the view of the Secretariat, offsets any potential benefits from possibly higher interest rates on United States dollar investments. The Secretariat prefers a conservative approach, that of lower return and lower risk, to that of higher return and higher risk.

17. On the other hand, the Secretariat agrees with the recommendation under paragraph 102 that a greater portion of the funds of the Organization should be entrusted to professional investment managers, who can then also address questions related to the optimum term of investments. The Secretariat has initiated discussions with three financial institutions to this effect, taking into account the considerations of security of investments and the level of management fees.

Bank accounts (paras. 104-105)

18. In addition to the closure of several bank accounts, as reported by the External Auditor, the Secretariat has closed seven additional accounts. The agreement for the establishment of a multi-currency account with one bank has been finalized and this account is now operative.

Contracts and purchases

Written policies and procedures (paras. 23, 110-113)

19. The Secretariat acknowledges the delay in finalizing the purchase and contracts manual. Its finalization is linked to the revision of the financial rules, some of which apply to contracts and purchases. The proposed revisions to the financial rules are expected to be completed by the end of 1996 and, likewise, the purchase and contracts manual is expected to be completed by the end of 1996. The manual will reflect the common guidelines on procurement in the United Nations system adopted in April 1996 by the United Nations Inter-Agency Procurement Working Group.

Technical cooperation activities

Project expenditure and regular budget expenditure (paras. 24-25, 114-120)

20. The Director-General has noted with great interest the analysis of technical cooperation expenditures. While appreciating the efforts of the External Auditor to measure UNIDO performance in the area of technical cooperations activities, the Director-General has a reservation on the concept and methodologies of the analysis and particularly on the conclusions drawn. The Director-General cautions against drawing conclusions on programme performance from aggregate financial information without examining the premises of the analysis.

21. At the concept level, the difficulty of designing meaningful performance measures and indicators must first be recognized. Performance measures may mislead as much as they inform if the users are unaware of the subtle limitations of measurement systems. Performance measures for UNIDO must be designed based on its new mission, strategy and objectives, all of which have recently undergone fundamental changes. A simple time-series analysis of financial figures would be misleading since all the standards against which UNIDO performance can be measured have changed, in addition to the radical reorganization and downsizing. Performance measures must also be clear whether they measure inputs, processes, outputs, outcomes or impacts, and if they measure the efficiency, cost/effectiveness or sustainability of UNIDO services.

22. It should be borne in mind that the integrated technical cooperation services of UNIDO cannot simply be measured by project delivery statistics in relation to Headquarters support services. The Secretariat has been called upon by Member States to perform a dual function: (a) world-wide forum for supporting and promoting industrial development; and (b) provider of integrated technical cooperation services. Both functions are interlinked with each other and with support services. The global forum function enables UNIDO to be at the forefront in the analysis of world-wide industrial trends and the identification of priority support requirements of different groups of developing countries. At the same time, issues emerging in the context of technical cooperation services often provide a stimulus for a broader exchange of experience at the regional or global level. None of the two functions could be carried out without basic support functions at Headquarters, i.e. programme and project development, research and statistical support, funds mobilization, substantive supervision, operational support services such as recruitment, fellowships, purchase and contracts, as well as financial management.

23. In addition to the above conceptual issues, methodological problems also arise. First, the General Fund figures for 1995 include an extraordinary item for termination indemnities in 1995 of $7.5 million. By excluding this charge, the technical cooperation/General Fund (TC/GF) ratio for 1995 increases to 0.90. Secondly, the expenditure figures are not adjusted for the falling value of the United States dollar vis-à-vis the Austrian schilling during the period 1986 to 1995. The falling value of the dollar, about 35 per cent during the period, "inflates" the costs of the General Fund and programme support costs which are largely schilling-based, compared to technical cooperation delivery, which is dollar-based. Adjustment for the falling dollar value would bring the ratios significantly upward, for instance, that of 1995 to 1.38, the level of 1986.

24. It is acknowledged that the suggested adjustments do not change the overall downward trend in the ratios during the last five years. It should be kept in mind, however, that the downward trend is caused, to a large extent, by the general decline in the flow of Official Development Assistance (ODA) funds to developing countries through the United Nations system, as implied in paragraph 120 of the report of the External Auditor. The declining resources have affected more the technical cooperation activities which are supported by voluntary, extrabudgetary resources than General Fund resources which are mandatory and budgetary. Furthermore, the Director-General is aware that a high volume of technical cooperation does not necessarily imply high quality of technical cooperation. The past drive to increase project delivery has sometimes led to the so-called "PAD syndrome" or "approval culture", whereby large-scale

projects were sought without due regard to quality. The Director-General is keen to maintain the balance between quality and volume of technical cooperation activities.

25. Member States may be advised that, if the ratio of the extrabudgetary contributions to the regular budget is to be used as a measure of efficiency or productivity, UNIDO is the most efficient/productive organization among the 13 specialized agencies, according to a Joint Inspection Unit survey made in 1993 (document IDB.16/12 refers). Furthermore, the Secretariat considers that a productivity measure defined in terms of technical cooperation project delivery per staff member is a better performance measure, and the ratio has gone up significantly in recent years due to both staff reduction and managerial process improvements.

26. For the above reasons, the Director-General cannot fully agree with the conclusions of the External Auditor stated in paragraphs 117 and 118 of her report. Having said that, the Director-General will continue his efforts to meet the increasing requests for UNIDO services by broadening the access to different sources of funds. The Secretariat, on the other hand, will continue its efforts to design relevant and practical performance measures/ indicators for UNIDO, through a working group established in 1995 for this purpose.

Project cycle management (paras. 26-32, 121-141)

27. With respect to country programming briefs, Director-General's bulletin UNIDO/DG/B.177 referred to in paragraph 122 of the report has since been superseded by Director-General's bulletin UNIDO/DGB(P).8. The new bulletin has adopted a more pragmatic approach. It centres around a regular dialogue between UNIDO and the Government of the recipient country, resulting in a common understanding on a focused UNIDO support programme in accordance with the country requirements and the new UNIDO thematic priorities. Country programming briefs will continue to be used where and when required; preparation is no longer mandated, however, in each case by the new bulletin.

28. As for the UNIDO Country Director (UCD) programme, the Secretariat acknowledges the observations of the External Auditor and is taking a number of corrective measures. Detailed information on this subject is provided in the report on field representation (IDB.16/19). The future structure of the field representation programme is of great concern to the Organization and is under in-depth review by the Policy Advisory Group on Field Representation. Based on the current financial situation of UNIDO, long-term strategy and plans require careful consideration and can only be finalized once the resource availability over a longer period is established.

29. Since about 20 UCD offices will be affected by the discontinuation of financing of these offices by the United Nations Development Programme (UNDP) beyond 1997, the Policy Advisory Group will examine various alternatives on how to secure the financial sustainability of the programme. Within the limits of the available financial resources, the structure and location of field offices will be designed accordingly, taking into account the criteria of relevance, cost-effectiveness and sustainability.

30. A draft revised standard post description for UCDs was prepared in March 1996 and is being finalized by the Advisory Group, taking into account the recent restructuring and greater decentralization of authority to the field offices. A UCD recruitment profile is now available that will be used for the establishment of an internal and external candidate roster. Headquarters staff and women will be given preference when identifying suitable candidates. A procedure for the recruitment and systematic rotation of UCDs is being developed. Finally, all UCDs were requested to submit a work plan as part of the new staff performance evaluation system, based on which a mid-term review and annual performance evaluation will be carried out. All in all, a comprehensive review of the assignment and management of UCDs has been initiated.

31. With respect to the guidance of UCDs by Headquarters, the Field Support Unit in the Office of the Managing Director, Country Programmes and Funds Mobilization Division (CFD), provides support to the management and coordination of the field offices. The field offices, both UCDs and Junior Professional Officers (JPOs), have been integrated with the respective Regional Bureau. The Secretariat is working out a new regular reporting system from UCD offices to Headquarters, and Internal Audit prepares periodic audits of selected UCD offices. As for the handbook for UCDs, a tentative outline was prepared and presented to the Policy Advisory Group in August 1995. The financial constraints faced by UNIDO as well as the ongoing reform process hindered its completion. The Policy Advisory Group will prepare a concept/outline of the handbook by the end of 1996.

32. Regarding comprehensive policy guidelines on project cycle management, the Secretariat wishes to emphasize that the main conceptual changes in the project cycle relate to the identification, development and approval of programmes and projects as well as the new approach to focus UNIDO activities. Director-General's bulletins UNIDO/DGB(P).8 and UNIDO/DGB(P).9 were

issued in April 1996, and training of staff is in progress. Parts of the new approach, for instance the Screening Committee for ad hoc projects, have been operating since the beginning of the year.

33. Changes in the project implementation phase relate to re-engineering of management and administrative processes involving a new coordination mechanism between several divisions. These changes entail a careful analysis, design, development and introduction of new procedures as well as computer systems. Given that this task is carried out while normal operations continue, this takes considerable time. Guidelines and regulations, however, have always existed even if not in a fully consolidated form. Consolidated guidelines and standards can be issued only when the re-engineering has been completed. Work on a Director-General's bulletin on project implementation is at an advanced stage and is expected to be finalized by the end of September 1996.

Information technology

Implementation of consultancy recommendation for further computerization of UNIDO
(paras. 33, 142-146)

34. The Secretariat agrees with the External Auditor that, before engaging in any future consultancies for information technology (IT), the financial feasibility of implementing the recommendations should be carefully evaluated. It is further agreed that an IT strategy is essential for the Organization as the basis on which to set priorities for application development that are aligned with the overall strategy of UNIDO. For this purpose, MIS, under the direction of ITMC, together with Activity Area 3 of the UNIDO reform, are currently preparing an IT strategy for consideration and approval of the Director-General.

35. Regarding the history of all IT consultancies carried out between 1991 and 1995, and the cost of $560,000, it is not accurate to consider them all as having had the purpose of helping the Organization find its information technology strategy. Indeed, the Touche Ross consultancy of 1991 at a cost of $240,000 was aimed primarily at identifying savings in the cost of the computerization programme; several smaller consultancies were aimed at identifying options for a more suitable facilities management contract, establishing database standards or evaluating software packages for technical cooperation and investment promotion activities. It would be accurate to consider the amount of $277,000 as the cost of two consultancies dedicated to IT strategy (Andersen Consultants in 1992 and Muraskievicz/Rybinski in 1995). These were useful exercises that gave UNIDO its information systems development methodology and a detailed description of recommended IT projects, many of which are still valid. The IT strategy under preparation will certainly rely on these consultancies as a starting point.

Development and implementation of EDP applications (paras. 34-35, 147-159)

36. The Secretariat wishes to stress that the travel information and coordination system (TRICOS) should be seen as an experiment at a cost of $30,000 from which UNIDO learned a number of lessons. It was a necessary step required in order to shift UNIDO into a different technology platform. The costs of the acquired hardware and generalized software should not be considered lost, since it is or will be used for other purposes. TRICOS as such has not and probably will not be used because its design was overtaken by technological developments, specifically the availability of the Internet within UNIDO, but the system was a catalyst that accelerated the implementation of (a) an adequate client/server platform for UNIDO and (b) an organizational environment for future applications development using such platform. Internal Audit has already looked into the matter and issued several recommendations.

37. As the External Auditor acknowledges, the investments made in the development of the procurement system have not been lost. The system is undergoing fine-tuning. Training for the requisition officers in the substantive divisions will be completed in summer 1996. The system will be test-implemented throughout the Secretariat starting from autumn 1996. With the agreement of all users, the system could then be implemented in the second quarter of 1997. A by-product of the overall use of this system is its effect on liquidity planning, as mentioned in paragraph 16 of the present document.

38. The Secretariat agrees with the External Auditor that new systems, or improvements in existing systems, need to be justified on the basis of a cost-benefit analysis, and that actual achievements need to be evaluated against the original objectives. The information technology strategy being formulated will be discussed by ITMC and at the top management level to arrive at a set of priorities based on the strategic needs of the Organization. A survey of high-level information requirements based on key business processes was initiated early in August 1996. Initially identified priority areas are those that: (a) support management decision-making (e.g. executive information systems); (b) support the service delivery processes of the Organization (e.g. country and/or sectoral information base); (c) add features or remove deficiencies in existing systems (e.g. cost accounting, online recording of all accounting transactions). Systems will be implemented according to a workplan that will

be monitored by ITMC to ensure that any obstacle which prevent the successful use of a system are identified and removed, on a timely basis.

Personnel matters

Financial information on the staff costs of substantive divisions of UNIDO (paras. 36-37, 160-162)

39. The Secretariat considers that the staff costs reflected for 1995 in table 11 should exclude the extra-ordinary charges in 1995 for termination indemnities. Excluding these charges would make the output ratio of technical cooperation expenditure per United States dollar spent on staff costs of substantive divisions 2.00 (External Auditor's report shows 1.89) and the share of staff costs of substantive divisions in total staff costs 63 per cent (External Auditor's report shows 62 per cent), which is a significant increase over the previous year 1994 (56 per cent). This, as noted by the External Auditor, reflects the Secretariat's efforts to maintain the high level achieved in the prior biennium. On the decline in technical cooperation expenditures in recent years, please refer to the comment of the Director-General in paragraphs 20 to 26 of the present document.

Organizational structure of UNIDO
(paras. 38, 163-171)

40. The Director-General would like to draw the attention of Member States that the General Conference approved the calendar of reform for 1996 as proposed by the Director-General (GC.6/Res.1), and this calendar is being followed. A detailed report was submitted to the Industrial Development Board at its fifteenth session (document IDB.15/14) and another is under preparation for the current session of the Board (IDB.16/18). The calendar foresees that the main thrust of the reform will be concluded as planned— by the end of 1996. Whereas the report of the consultant is being used to steer the reform efforts, the Director-General intends to follow the guidance of Member States.

The 1995 staff reduction exercise
(paras. 39-40, 172-180)

41. The Secretariat wishes to point out that, as of 31 July 1996, expenditures from the separation indemnity reserve for voluntary and non-voluntary separations for the 1995 exercise amounted to $13.6 million. Total payments, including outstanding liabilities, are expected to remain below the authorized ceiling of $17 million. The doubts expressed by the External Auditor as to whether the amount set aside for this purpose would be sufficient seems to be based on the contingency plan, which provided for a reduction of 60 Professional and 180 General Service *posts*. In *staff* terms, however, only 128 staff members took an agreed termination, while 17 staff members were compulsorily laid off at the end of June 1996. The contracts of 38 short-term and 30 time-limited[1] were simply allowed to expire, without creating additional financial liabilities.

42. While appreciating the comment of the External Auditor that the staff reduction exercise was caused by circumstances beyond the control of UNIDO, the Director-General would not agree with the suggestion that UNIDO enforced a staff reduction without due consideration of such factors as workload measurements. The organizational and functional structures of each division were carefully reviewed by the external consultant in late 1995. Each Managing Director identified low priority workload areas and proposed posts for abolition as part of a restructuring process with a view to maintaining programme effectiveness while reducing costs. The Director-General will continue his efforts to enhance the economy and efficiency of the Organization with the support of all staff of the Organization and Member States.

Other matters

Finance manual (paras. 41, 181-189)

43. The Secretariat agrees with the recommendation of the External Auditor and has taken action to complete and update the finance manual, and to distribute the revised manual to all staff members carrying out financial functions in the Organization by early 1997.

III. ACTION REQUIRED OF THE COMMITTEE

44. The Committee may wish to take note of the comments of the Director-General and actions taken by the Secretariat which are contained in the present document in response to the report of the External Auditor for the biennium 1994-1995.

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[1]Includes 200 series intermediate and short-term and fixed-term (under 100 series) staff.